

Morgan Stanley

2016 Resolution Planning

Public Section

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## MORGAN STANLEY RESOLUTION PLANNING OCTOBER 2016 PUBLIC SECTION

1	Executive Summary .....	3
2	Resolution Planning Governance .....	12
3	Overview of the Firm's Resolution Strategy .....	12
4	Plans to Address Areas of Vulnerability .....	15
4.1	Liquidity .....	15
4.1.1	Resolution Liquidity Adequacy and Positioning .....	16
4.1.2	Resolution Liquidity Execution Need .....	18
4.2	Derivatives and Trading Activities .....	19
4.3	Governance Mechanisms .....	20
4.3.1	Playbooks and Triggers .....	21
4.3.2	Pre-Bankruptcy Parent Support .....	21
4.4	Capital .....	22
4.4.1	Resolution Capital Adequacy and Positioning .....	22
4.4.2	Resolution Capital Execution Need .....	23
4.5	Operational .....	23
4.5.1	Payment, Clearing and Settlement Activities .....	23
4.5.2	Managing, Identifying and Valuing Collateral .....	24
4.5.3	Management Information Systems .....	24
4.5.4	Shared and Outsourced Services .....	24
4.5.5	Bankruptcy and ISDA Protocol Playbooks and Emergency Motion .....	25
4.6	Legal Entity Rationalization and Separability .....	25
5	Conclusion .....	26
6	Forward-Looking Statements .....	28
	Appendix A: Material Entities of Morgan Stanley as of the 2015 Plan .....	29
	Appendix B: Core Business Lines of Morgan Stanley as of the 2015 Plan .....	34

# 1 Executive Summary

Morgan Stanley (as a stand-alone parent holding company, “**MS Parent**,” and on a consolidated basis, the “**Firm**”) is a global financial services firm that, through its subsidiaries and affiliates, advises, and originates, trades, manages and distributes capital for, governments, institutions and individuals. The Firm conducts its business from its headquarters in and around New York City, its regional offices and branches throughout the U.S. and its principal offices in London, Tokyo, Hong Kong and other world financial centers. The Firm is committed to managing its operations to promote the integrity of the financial system and fulfilling its responsibility to maintain the highest standards of excellence.

In its resolution planning, the Firm is guided by and committed to two key objectives:

- Operating in a manner and with a culture that contributes to the safety and soundness of the global financial system; and
- Enhancing its resilience and resolvability.<sup>1</sup>

The credibility of the Firm’s Resolution Strategy is rooted in three primary tenets:

- A strategic and legal framework that is appropriately tailored to the Firm’s operating model and legal entity structure;
- Financial adequacy; and
- Operational continuity and capabilities.

The Firm’s Resolution Strategy is designed to provide assurance that customers, counterparties and creditors of the Firm’s Material Entities<sup>2</sup> will be paid without any interruption in the Firm’s Critical Operations<sup>3</sup> or Critical Economic Functions<sup>4</sup> and without the costs of multiple, potentially

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<sup>1</sup> Section 165(d) of Title I of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “**Dodd Frank Act**”) and the regulations promulgated thereunder (the “**165(d) Rule**”) require the Firm to demonstrate how MS Parent could be resolved under the U.S. Bankruptcy Code, without extraordinary government support and in a manner that substantially mitigates the risk that the failure of the Firm would have serious adverse effects on U.S. financial stability. In conformity with this requirement, the Firm’s 2015 Title I Resolution Plan (the “**2015 Plan**”) presented the Firm’s strategy for resolution of the Firm (the “**Resolution Strategy**”) upon material financial distress or failure in a severely adverse macroeconomic environment.

This “**Public Section**” is submitted pursuant to the April 14, 2016 joint feedback letter (the “**2016 Feedback**”) that (i) acknowledged the progress the Firm has made in enhancing its resolvability and (ii) identified certain shortcomings in the 2015 Plan and the April 12, 2016 Guidance for 2017 (the “**2017 Guidance**”) received from the Board of Governors of the Federal Reserve System (the “**Federal Reserve**”) and the Federal Deposit Insurance Corporation (the “**FDIC**” and collectively the “**Agencies**”). The 2016 Feedback requires the Firm to submit a public section that explains, at a high level, the actions the Firm plans to take to address the Agency-identified shortcomings prior to the submission of its 2017 Title I Resolution Plan (the “**2017 Plan**”). The Firm is also required to submit a confidential section containing a status report on the Firm’s actions to address the Agency-identified shortcomings (collectively with the Public Section, the “**2016 Submission**”).

<sup>2</sup> A description of the Firm’s Material Entities is included as Appendix A to this Public Section.

<sup>3</sup> As defined in the 165(d) Rule.

competing, insolvency or resolution proceedings. The Firm's substantial capital and liquidity reserves, as well as the increase in the durability of the Firm's funding, including longer weighted average maturity and a significant increase in deposits, in combination with its financial modeling and stress testing efforts, are designed to demonstrate that Material Entities would have access to the capital and liquidity necessary to execute the Firm's Resolution Strategy without threatening the pre-failure resiliency of MS Parent. Finally, the Firm has made marked progress in demonstrating how each Material Entity would have access to the critical personnel, systems, applications, facilities, vendors and other non-financial resources needed to execute its Resolution Strategy and its ability to produce the data and information and perform the processes necessary to execute its Resolution Strategy. Together, the Firm's continued focus on each of these three elements supports the credibility of the Resolution Strategy and demonstrates the Firm's increased resilience and resolvability.

The Firm's commitment to resolution planning and to enhancing its resolvability is reflected in:

- The overarching governance structure that the Firm has implemented, with focused senior management oversight;
- The Firm's efforts to restructure its business practices, both in response to Agency feedback and of its own volition; and
- The ownership and oversight of particular functions directly by applicable business units or support and control functions, fostering the integration of resolvability themes directly into business-as-usual ("**BAU**") processes and Firm culture.

The Firm's resolution planning efforts are grounded in:

- Bottom-up financial modeling and analysis, including sensitivity analyses, to demonstrate that the Firm has adequate resources to execute its Resolution Strategy in a range of scenarios;
- Mechanisms designed to ensure that financial resources will be made available to Material Entities to meet their needs in resolution in a way that seeks to preserve the value of the Firm's Material Entities and minimizes legal risks, as evidenced by an executed Support Agreement (the "**2015 Support Agreement**");
- Governance mechanisms designed to ensure timely decision-making and action execution, as well as oversight over the resolution planning process;
- Providing for the continuity of critical operational services throughout a resolution period, including by comprehensively restructuring the Firm's entities to provide for a service entity network separate from its operating entities;
- A legal entity structure designed to promote separability of the Firm's business lines and not impede execution of the Resolution Strategy, including through the maintenance of (i) separate broker-dealer entities to support the Firm's Institutional Securities Group ("**ISG**") and Wealth Management Core Business Lines<sup>5</sup> and (ii) separate investment advisor entities to support the Firm's Investment Management Core Business Line; and

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<sup>4</sup> As designated by UK regulatory authorities.

<sup>5</sup> A description of the Firm's Core Business Lines is included as Appendix B to this Public Section.

- Underlying capabilities designed to support the feasibility of managing the Firm in a crisis and executing the Resolution Strategy, if necessary.

The 2016 Feedback and 2017 Guidance issued to each of Morgan Stanley and seven other large financial institutions was divided into six topics: (i) Liquidity, (ii) Derivatives and Trading Activities, (iii) Governance Mechanisms, (iv) Capital, (v) Operational and (vi) Legal Entity Rationalization and Separability. The 2016 Feedback evaluated each large financial institution's 2015 resolution plan and highlighted areas of required remediation for each institution, with each such area being described as either a "shortcoming" (which is required to be addressed in that institution's 2017 resolution plan) or a "deficiency" (which is required to be addressed in that institution's 2016 submission, unless only one of the Agencies found the relevant aspect of the 2015 resolution plan deficient, in which case it qualifies as a shortcoming).

Of those eight financial institutions who received the 2016 Feedback, Morgan Stanley's 2015 Plan was one of only three plans in which the Agencies did not jointly identify any deficiencies.<sup>6</sup> The 2016 Feedback noted that "over the past several years, [Morgan Stanley] has taken important steps to enhance the Firm's resolvability and facilitate its orderly resolution in bankruptcy," and proceeded to highlight some of the actions that the Firm has already completed to enhance its resolvability and resilience. The Agencies did identify certain shortcomings in the Firm's 2015 Plan in three of the six areas mentioned above, (i) Liquidity, (ii) Derivatives and Trading Activities and (iii) Governance Mechanisms. The Firm is already taking actions to remediate these shortcomings in advance of the 2017 Plan, where such remediation efforts will be described in detail. Because the Agencies did not jointly identify any deficiencies with respect to the Firm's 2015 Plan, the Firm's obligation for the 2016 Submission is to produce (i) a confidential section describing the Firm's actions to address the shortcomings and (ii) this Public Section explaining, at a high level, the actions the Firm plans to take to address such shortcomings.

The Firm is not only addressing Agency-identified shortcomings, but is continuing to execute the commitments made in its 2015 Plan and enhancing its resolvability capabilities pursuant to additional Agency guidance as well as self-identified areas for improvement. In addition, the Firm recognizes the inherent uncertainty in the resolution planning process, and is focused on enhancing its resolvability across a range of scenarios, including in the event of potential ring-fencing. While the Firm cannot anticipate every possible scenario, it has become more resilient to greater stresses and is more resolvable in a much wider range of circumstances.

The Firm has already taken substantial actions to improve its resiliency and resolvability with respect to each substantive topic area identified in the 2016 Feedback and 2017 Guidance and will take further action both where required by the 2016 Feedback and 2017 Guidance and where it determines that such action would improve the Firm's resiliency and resolvability capabilities.

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<sup>6</sup> The Federal Reserve considered one item with respect to Liquidity that requires remediation to be a deficiency. Because only one of the Agencies found the item to be a deficiency, this item qualifies as a shortcoming.

## **Liquidity**

Prior to the submission of the 2015 Plan, the Firm had already taken substantial actions with respect to the Liquidity items identified in the 2016 Feedback and 2017 Guidance. Among other things, the Firm:

- Developed a financial model (the “**Resolution Financial Model**”) to determine the amount and location of liquidity and capital required to execute its Resolution Strategy. The liquidity and capital metrics quantified by the Resolution Financial Model are akin to the estimates of Resolution Liquidity Execution Need (“**RLEN**”) and Resolution Capital Execution Need (“**RCEN**”) that are required by the 2016 Feedback and 2017 Guidance;
- Developed robust methodologies to model liquidity outflows over multiple time horizons across a range of scenarios;
- Improved the overall durability of the Firm’s funding structure, including increasing weighted average maturity and diversifying the Firm’s funding structure;
- Maintained a substantial liquidity reserve of \$207 billion as of 2Q16, which was a 76% increase from 4Q07, despite decreasing the Firm’s total assets from \$1.045 trillion to \$829 billion (a decrease of 21%) over the same time period;<sup>7</sup> and
- Entered into the 2015 Support Agreement, which utilized the Resolution Financial Model, to facilitate the provision of sufficient capital and liquidity resources to its Material Entities to execute the Resolution Strategy.

In addition to continuing to improve on the actions described above, the Firm is undertaking the following additional enhancements in response to the 2016 Feedback and the 2017 Guidance on Liquidity:

- Developing and implementing a new Resolution Liquidity Adequacy and Positioning (“**RLAP**”) model to estimate and maintain sufficient available liquidity for Material Entities, while taking into account resolution and ring-fencing considerations, as well as inter-affiliate frictions;
- Fundamentally changing how the Firm manages its cash in order to reduce or eliminate the amount of cash that might not be readily available to Material Entities upon the failure of MS Parent;
- Developing a multi-factor quantitative and qualitative financial resource positioning framework which will determine the appropriate level of liquidity and capital to be held at each Material Entity and at MS Parent. This will result in an increase to the already substantial resources currently positioned at the Material Entities; and
- Enhancing its Minimum Operating Liquidity (“**MOL**”) methodology for calculating its RLEN while taking into account inter-affiliate frictions that may impact liquidity needs and attributing needs for working capital and operating expenses.

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<sup>7</sup> Liquidity reserve was \$188 billion and total assets were \$826 billion as of 2Q15.

## ***Derivatives and Trading Activities***

The Firm had already completed Derivatives and Trading Activities-related actions prior to the submission of its 2015 Plan. Among other things, the Firm:

- Developed the Resolution Financial Model to model the financial impact of actively winding down the Firm's derivatives and trading business;
- Revised its booking model to decrease financial interconnectedness within ISG;
- Adhered to the International Swaps and Derivatives Association 2015 Universal Resolution Stay Protocol (the "**ISDA Protocol**");
- Undertook an ongoing project to analyze and remediate a wide range of qualified financial contracts ("**QFCs**") that have the potential to disrupt a rapid and orderly resolution;
- Developed a playbook (the "**Customer Asset Transfer Playbook**") to confirm the Firm's ability to transfer Prime Brokerage customer assets to alternate providers while the Firm is in material financial distress;
- Projected the residual sales and trading portfolio that would remain for each Material Entity following a 12-month active wind down, with the previously developed capability to provide a level of detail that is consistent with the 2016 Feedback and 2017 Guidance;
- Re-examined all risk management hubs and associated material inter-affiliate derivative configurations and implemented the required capabilities and governance framework to support controls over its external and inter-affiliate derivatives booking practices; and
- Created communications playbooks for key stakeholders, including clients, regulators, top financial market utilities ("**FMUs**") and agent banks and rating agencies, to cover a range of recovery and resolution scenarios.

In addition to continuing to improve on the actions described above, the Firm is undertaking the following additional enhancements in response to the 2016 Feedback and 2017 Guidance on Derivatives and Trading Activities:

- Modifying assumptions regarding the use of hedges in connection with the Firm's active wind down analysis;
- Providing in the 2017 Plan already developed, detailed characteristics of the non-systemic residual derivatives portfolio remaining after 12 months of wind down;
- Defining a Stabilization Period<sup>8</sup> and related actions for the Firm's trading entities<sup>9</sup> to demonstrate their continued solvency following the bankruptcy filing of MS Parent;
- Developing a highly tailored playbook (the "**Rating Agency Playbook**"), which will explain how the Firm would communicate with rating agencies to keep its ratings at as high a level as possible during the resolution of the Firm;
- Enhancing its global communications strategy with key stakeholders to facilitate the successful execution of the Resolution Strategy in the form of an enhanced communications playbook (the "**Financial Stress Communications Playbook**");

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<sup>8</sup> As described in the 2017 Guidance.

<sup>9</sup> Material Entities with more than de minimis derivatives activity.

- Enhancing the Resolution Financial Model to estimate the financial resources required to support a passive wind down of the Firm’s derivatives and trading portfolio;
- Continuing to automate its Resolution Financial Model; and
- Enhancing analytical capabilities to capture inter-affiliate derivative market risk sensitivities and liquidity impacts from inter-affiliate derivative transactions.

### ***Governance Mechanisms***

The Firm had already completed Governance Mechanisms-related actions prior to submission of its 2015 Plan. Among other things, the Firm:

- Executed the 2015 Support Agreement, which included capital and liquidity based triggers to (i) mark the onset of the Runway Period<sup>10</sup> and (ii) recapitalize MS Parent’s Material Entities when MS Parent would still have sufficient resources for the Material Entities to execute the Resolution Strategy;
- Secured MS Parent’s obligations under the 2015 Support Agreement with security interests in MS Parent’s intercompany receivables;<sup>11</sup>
- Developed triggers to escalate information and resolution-related decisions to the MS Parent Board; and
- Developed a playbook (the “**Governance Playbook**”) that sets out resolution-related considerations and potential actions for the Boards of MS Parent and its Material Entities.

In addition to continuing to improve on the actions described above, the Firm is undertaking the following additional enhancements in response to the 2016 Feedback and 2017 Guidance on Governance Mechanisms:

- Entering into an amended support agreement (the “**2017 Support Agreement**”) to incorporate an enhanced trigger and escalation framework and to align the terminology of the agreement to the nomenclature used in the 2016 Feedback and 2017 Guidance;
- Enhancing the Firm’s support agreement framework so that the provision of support under the 2017 Support Agreement is more resilient to legal risks, based on the completed detailed legal analysis of creditor challenges;
- Enhancing the Firm’s trigger and escalation framework to ensure timely decision-making, including, among other things, the incorporation of a trigger that directly connects the decision to provide MS Parent support to the Material Entities with the decision for MS Parent to file for bankruptcy;
- Enhancing the collateral for and perfecting the security interests in substantially all of MS Parent’s material assets (other than the stock of its subsidiaries) under the 2017 Support Agreement; and
- Creating individual Governance Playbooks for the MS Parent Board and each Material Entity Board, improving upon the Governance Playbook in the 2015 Plan.

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<sup>10</sup> As described in the 2017 Guidance.

<sup>11</sup> The 2015 Security Agreement is subject to final execution by certain beneficiaries.

## **Capital**

The Firm had already completed Capital-related actions prior to submission of its 2015 Plan. Among other things, the Firm:

- Improved its overall capital position, from \$58.7 billion of Common Equity Tier 1 Capital on June 30, 2015 to \$59.8 billion as of June 30, 2016, and maintained a level of total loss absorbing capacity (“TLAC”)-eligible unsecured debt that is in excess of the minimum TLAC requirement into 2022 based on the Firm’s assessment of the current proposed rule;<sup>12</sup> and
- Developed an approach to estimating the liquidity and capital required to execute the Resolution Strategy that is generally consistent with the 2017 Guidance on RLEN and RCEN.

The Firm’s 2016 Feedback did not include any Capital-related shortcomings. Nonetheless, the Firm is undertaking the following additional enhancements in connection with the 2017 Guidance on Capital, in addition to continuing to improve on the actions described above:

- Enhancing the processes that support the maintenance of loss absorbing capital to address the 2017 Guidance;
- Developing a multi-factor quantitative and qualitative financial resource positioning framework which will determine the appropriate level of liquidity and capital to be held at each Material Entity and at MS Parent. This will result in an increase to the already substantial resources currently positioned at the Material Entities;
- Reviewing the characteristics of inter-company debt between all entities in the chain between MS Parent and Material Entities in order to mitigate potential creditor challenges to internal loss absorbing capital; and
- Amending terminology associated with capital execution needs in the 2017 Support Agreement and 2017 Plan.

## **Operational**

The Firm had already completed Operational continuity-related actions prior to submission of its 2015 Plan. Among other things, the Firm:

- Designated “**Material Service Entities**” that compose the Firm’s global service entity network. On March 1, 2016, the Firm successfully migrated the U.S. technology organization, transferring \$1 billion in fixed assets, 3,202 employees and 5,600 contracts from its U.S. broker-dealers into its primary U.S.-domiciled Material Service Entity;
- Included five playbooks (each an “**FMU and Agent Bank Access Playbook**”) in its 2015 Plan which analyzed how to maintain access to select FMUs and accounted for the contingency that one or more FMU memberships could be suspended or terminated;

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<sup>12</sup> The Firm estimates its pro forma external TLAC based on the Firm’s current assessment of the Notice of Proposed Rule Making (“NPR”) released on October 30, 2015. The Firm’s interpretation of the NPR includes the Firm’s expectations of the proposed requirements, which may be subject to change as the Firm receives additional clarification and guidance.

- Established a formal process (the “**Annual Resolution Enhancement Assessment**” or “**AREA**” process) and supporting systems to enable the Firm to objectively analyze and formally assess the sufficiency of existing practices required to (i) support the capabilities required to manage the Firm through a range of stress events, including resolution, (ii) identify critical operational or technology data gaps in the Firm’s ability to execute the Resolution Strategy and (iii) determine, assign and monitor related enhancement efforts;
- Executed or updated service level agreements between Material Entities as of June 2015, with the execution of inter-affiliate transfer pricing arrangements and inter-affiliate agreements for the ongoing use of intellectual property;
- Drafted a “**Guarantee Administrative Priority Motion**” that would elevate guarantees of subsidiary QFCs to administrative expense status, consistent with the requirements of the ISDA Protocol.

The Firm’s 2016 Feedback did not include any Operational continuity-related shortcomings from the Agencies. Nonetheless, the Firm is undertaking the following additional enhancements in connection with the 2017 Guidance on Operational continuity matters, in addition to continuing to improve on the actions described above:

- Completing the migration of shared services to its global network of Material Service Entities;
- Updating inter-affiliate agreements in line with the adoption of the global Material Service Entity network and related migrations;
- Developing enhanced FMU and Agent Bank Access Playbooks for each of the Firm’s top 20 FMU relationships and drafting new playbooks that cover the Firm’s relationship with (i) its top agent bank and (ii) other top agent banks, demonstrating the Firm’s ability to meet potential heightened requirements in material financial distress;
- Implementing a governance and communications protocol that would govern direct communications with FMUs and agent banks during periods of stress and in resolution;
- Further enhancing the Firm’s MIS capabilities and its ability to manage, identify and value collateral;
- Compiling all critical contracts in appropriate databases to enhance the Firm’s ability to identify those contracts and related terms and provisions; and
- Developing a playbook (the “**Bankruptcy Playbook**”) setting forth MS Parent’s strategic actions from the “**Stress Period**” through the “**Resolution Period**,”<sup>13</sup> including an “**ISDA Protocol Playbook**” and an enhanced Guarantee Administrative Priority Motion.

### ***Legal Entity Rationalization and Separability***

The Firm had already completed Legal Entity Rationalization and Separability-related actions prior to submission of its 2015 Plan. Among other things, the Firm:

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<sup>13</sup> Both as described in the 2017 Guidance.

- Developed a legal entity rationalization (“LER”) framework with specific criteria that improves the resolvability of the Firm;
- Reduced the number of consolidated legal entities by 35% between 4Q07 and 2Q16;
- Adopted a structure with (i) separate broker-dealer entities and ownership chains to support the Firm’s ISG and Wealth Management Core Business Lines and (ii) separate investment advisor entities to support the Firm’s Investment Management Core Business Line;
- Improved the separability of its legal entity structure to support its business sale strategies and the resiliency of its inter-affiliate relationships to support its wind down strategies;
- Complied with the Agencies’ prior guidance on clean holding companies by stopping the issuance by MS Parent of debt with original maturity of less than one year, limiting MS Parent’s external derivatives portfolio and adopting a policy to prohibit guarantees of MS Parent’s obligations by its subsidiaries.
- Enhanced the existing legal entity management processes to include resolvability considerations; and
- Confirmed that the equity ownership structure of Firm entities does not materially impact the Firm’s resolvability.

The Firm’s 2016 Feedback did not include any Legal Entity Rationalization and Separability-related shortcomings from the Agencies. Nonetheless, the Firm is undertaking the following additional enhancements in connection with the 2017 Guidance on Legal Entity Rationalization and Separability matters, in addition to continuing to improve on the actions described above:

- Developing and implementing a policy to define roles and responsibilities within the LER process, designed to ensure that it is carried out on a continuous basis and to provide a centralized environment for the collection of information related to each LER criterion;
- Enhancing its separability analysis for sale options;
- Evaluating the Firm’s adherence to the LER criteria, including through a review and challenge process as well as approval of the results by the Firm’s Legal Entity Oversight and Governance Committee;
- Evaluating on an annual basis the necessary buyer due diligence documents to be stored within a data room; and
- Enhancing its Marketing and Sales Playbook and creating data rooms for the businesses it intends to sell under its Resolution Strategy.

As demonstrated by the above, the Firm has made significant progress towards the requirements contained in the 2016 Feedback and 2017 Guidance. The Firm will complete any remaining required remediation in connection with the 2016 Feedback and 2017 Guidance by July 2017 and will describe the results of its efforts in the 2017 Plan.

The remainder of this Public Section provides an overview of the resolution planning governance structure and processes that have been established as part of the Firm’s commitment to enhance its resolvability. The Public Section then summarizes the Firm’s Resolution Strategy and describes in more detail the Firm’s plans to address the 2016

Feedback and 2017 Guidance for each of the six substantive topic areas identified above, before concluding with a statement on the efforts the Firm is taking to ensure its continued resiliency and resolvability across all vulnerabilities identified by the Agencies.

## 2 Resolution Planning Governance

The Firm has established a robust resolution planning and governance framework designed to ensure that all aspects of resolution planning—including development, review, approval and maintenance of the resolution plan—receive appropriate attention from both management and the Board of Directors of MS Parent. The governance framework leverages established roles and responsibilities and committee charters, and incorporates enhancements specifically designed to address resolution planning. As a result, resolution plan development, review, approval and maintenance activities at the Firm are fully integrated into its corporate governance structure.

The Firm's dedicated central resolution and recovery planning function ("**Firm RRP**") is responsible for managing the development, submission and maintenance of the 2016 Submission and monitoring the progress of related remediation projects. The resolution planning process is overseen by the senior management of the Firm and an RRP Steering Committee, and is managed by Firm RRP. Resolution planning has become an integrated, BAU process at the Firm, with defined components owned directly by applicable business units or support and control functions, fostering the integration of resolvability themes directly into BAU processes and Firm culture.

## 3 Overview of the Firm's Resolution Strategy

Consistent with the Firm's key objectives and through its governance processes, the Firm has developed its Resolution Strategy and articulated how this strategy could be successfully implemented by the Firm within the time frames and under the stress conditions mandated by the Agencies without taxpayer or government support and without disruption to U.S. and global financial stability. To develop its Resolution Strategy, the Firm has used a hypothetical failure scenario and associated assumptions mandated by regulatory guidance (the "**Hypothetical Resolution Scenario**"). Under the Hypothetical Resolution Scenario, the Firm is required to assume that it would face a severe idiosyncratic stress event in a severely adverse economic environment, requiring resolution of the Firm. The Firm is also required to assume that it does not take any recovery actions or that any recovery actions taken would not be successful. The Plan describes how, in the Hypothetical Resolution Scenario, MS Parent could be resolved in a manner that satisfies the requirements of the 165(d) Rule.

The Hypothetical Resolution Scenario and the related assumptions are hypothetical and do not necessarily reflect an event or events to which the Firm is or may become subject. The Firm's resolution planning efforts are aimed at increasing the Firm's resilience and resolvability under a variety of scenarios. The Hypothetical Resolution Scenario includes a set of extremely severe economic assumptions, which require the Firm to absorb large losses and experience severe

liquidity outflows in a severely adverse economic environment. The Resolution Strategy is not binding on any court or other resolution authority. The Resolution Strategy is dynamic and, in the unlikely event that a real event of material financial distress were to occur, actual events at the time would be based on the facts and circumstances during the actual period of material financial distress, including decisions and actions of regulators and other parties at the time.

The Firm adopted a Single Point of Entry (“**SPOE**”) strategy as its Resolution Strategy in its 2015 Plan. Under the SPOE strategy, only MS Parent would enter insolvency proceedings and the Firm’s Material Entities would either be sold or wound down on a solvent basis outside of standalone resolution proceedings. At the end of the Resolution Period, the Firm would essentially no longer exist. The Firm has dedicated considerable efforts to developing this SPOE strategy, including building a new financial model and engaging resources throughout the entire Firm to reassess and update the Firm’s analysis and confirm the financial and operational feasibility of the strategy. Under the SPOE strategy, the Firm is resolvable under the Hypothetical Resolution Scenario, as well as in a wide range of alternative failure scenarios.

The main objectives guiding the development of the SPOE strategy are:

- Continuity of performance to the customers and counterparties of the Firm’s designated Critical Operations and Critical Economic Functions;
- Minimizing the re-transmission of the Firm’s liquidity distress into the market due to:
  - Payment defaults on short-term obligations;
  - Collateral liquidations by derivatives and repo counterparties that terminate their contracts against the Firm;
  - Fire sales of assets by the Firm to keep up with its financial obligations; and
  - Trapping of customer assets.
- Maintaining marketability and separability of business lines across a full range of scenarios;
- Ensuring no reliance on U.S. or foreign government financial support; and
- Ensuring no significant risk to the FDIC’s Deposit Insurance Fund.

In addition to the significant amount of capital and liquidity resources already positioned in the Material Entities, MS Parent maintains substantial assets that can be utilized for purposes of recapitalizing and providing liquidity support to its Material Entity subsidiaries during a stress event. Under the Hypothetical Resolution Scenario, if an idiosyncratic stress event occurs and recovery is not possible, the Firm would use these resources to execute its Resolution Strategy:

- In connection with the 2017 Plan, MS Parent will enter into the 2017 Support Agreement with each of its Material Entities, which will be designed to ensure its Material Entities have sufficient capital and liquidity as and when needed in the event of material financial distress during which recovery actions are unsuccessful. The 2017 Support Agreement will be an enhanced version of the 2015 Support Agreement.
- Under the 2017 Support Agreement, in the event of material financial distress during which recovery actions are unsuccessful, MS Parent would be obligated to contribute or loan on a subordinated basis all of its material assets, other than the stock of its

subsidiaries and certain intercompany payables, to provide capital and liquidity, as applicable, to the Material Entities.

- The obligations of MS Parent under the Support Agreement will be secured on a senior basis by substantially all of the material assets of MS Parent (other than the stock of its subsidiaries). As a result, claims of the Material Entities against the assets of MS Parent (other than the stock of its subsidiaries) will be effectively senior to unsecured obligations of MS Parent. MS Parent, like most parent holding companies, has no operations and depends on dividends, distributions and other payments from its subsidiaries to fund dividend payments and to fund all payments on its obligations, including debt obligations.
- MS Parent would deploy its capital and liquidity resources under the 2017 Support Agreement to support its Material Entities in order to seek to preserve their value, including by providing additional capital and liquidity needed in order to preserve the value of the Firm's Material Entities for MS Parent stakeholders and to permit orderly resolution of the Firm in a manner that minimizes systemic risk.
- After providing that the Material Entities have sufficient financial resources to execute the Resolution Strategy, MS Parent would enter proceedings under the U.S. Bankruptcy Code.
- None of the Firm's Material Entities would enter bankruptcy, insolvency or resolution proceedings, and the Material Entities would have sufficient available liquidity to meet payment obligations without selling assets at fire-sale prices.
- Early in its bankruptcy proceeding, MS Parent would seek necessary court approvals that would meet the requirements of amendments being made to the Material Entities' financial contracts pursuant to the ISDA Protocol. These approvals would eliminate termination rights arising out of the commencement of MS Parent's bankruptcy proceeding.
- The Firm's Wealth Management business (including Morgan Stanley Bank N.A. ("**MSBNA**") and Morgan Stanley Private Bank N.A.) and Investment Management business, which are structured to avoid material losses and to be severable from the rest of the Firm, would continue after the failure of MS Parent and, ultimately, be sold. Those businesses would continue to operate without disruption to their Critical Operations or client services, and they would continue to meet customer and depositor obligations in the ordinary course of business.
- Each of the ISG's U.S., UK and Japan "**Material Operating Entities**" would be wound down in an orderly manner without commencement of insolvency or resolution proceedings and without requiring extraordinary government support. Access to the Critical Operations of ISG would be maintained while clients' assets would be transferred to other market participants upon client request; portfolios of financial contracts would be serviced without default, or wound down or novated on a negotiated basis; and continued access to top FMUs and agent banks would facilitate continuity of clearing and settlement.
- During MS Parent's bankruptcy proceeding and the sale and wind down of the Firm's Critical Operations and Core Business Lines, the Firm's operational capabilities would

remain in place, due to the continuity of services and resources provided through a global network of Material Service Entities.

The Firm strongly believes that its Resolution Strategy has the following significant advantages, among others:

- It preserves the value of Core Business Lines and Critical Operations by allowing them to be sold or wound down in an orderly fashion without the Material Entities entering insolvency or resolution proceedings.
- Wealth Management brokerage customers and prime brokerage customers retain seamless, full and timely access to their accounts and are fully protected during the execution of the Resolution Strategy, and neither MSBNA nor Morgan Stanley Private Bank N.A. depositors nor the FDIC's Deposit Insurance Fund suffer losses.
- All liabilities of Material Entities are paid as they become due, including liabilities to derivatives counterparties, which will either be paid as scheduled or through novations or consensual tear-ups.
- The early terminations of financial contracts based on cross-default rights, and related significant losses, are avoided.
- Secured funding counterparties are able to receive payment of cash without foreclosing on securities collateral, and securities lenders are able to receive their securities without foreclosing on cash collateral.
- No customer assets are trapped.

The Firm strongly believes that the Resolution Strategy is executable from a business, financial and operational point of view. The financial feasibility of the Resolution Strategy has been analyzed using conservative assumptions and detailed, robust capital and liquidity frameworks. The Firm continues to take significant steps to ensure that its Resolution Strategy is operationally feasible, as described in the sections below.

## **4 Plans to Address Areas of Vulnerability**

This section describes the actions that the Firm is taking to address any shortcomings, as well as the additional requirements contained in the 2017 Guidance.

### **4.1 Liquidity**

With respect to Liquidity, the 2016 Feedback noted that the Firm did not have an appropriate model and process for estimating and maintaining sufficient liquidity at or readily available to Material Entities in resolution, while also noting that the Firm's funding model relied heavily on the Firm's ability to shift substantial amounts of liquidity around the organization when experiencing stress, which makes the Resolution Strategy potentially vulnerable to adverse actions by third-parties, including ring-fencing. The 2016 Feedback also described the Firm's reliance on certain MS Parent deposits that are held at agent banks to recapitalize and provide liquidity to its Material Entities in resolution, while noting that such deposits may become unavailable during severe stress.

The 2016 Feedback noted that the Firm should develop and implement an enhanced resolution liquidity model to address this shortcoming that should:

- Measure the stand-alone liquidity position of each Material Entity;
- Cover a period of at least 30 days and reflect the idiosyncratic liquidity profile and risk of the Firm;
- Balance the reduction in frictions associated with holding liquidity directly at Material Entities with the flexibility provided with holding liquidity at MS Parent;
- Ensure that MS Parent holds sufficient liquidity to cover the sum of all stand-alone Material Entities' net liquidity deficits; and
- Not assume that a net liquidity surplus at one Material Entity could be moved to cover a shortfall at another Material Entity.

The 2016 Feedback also noted that the 2015 Plan had a shortcoming in its model and process for estimating the liquidity needed to fund the Material Entities during the Resolution Period. Specifically, the model was not able to produce a detailed breakout of inter-affiliate flows that may impact liquidity needs, and supporting analysis demonstrating how the MOL level was determined was not provided. To address this shortcoming, the 2016 Feedback stated that the Firm's 2017 Plan should include detailed support for and analysis on the estimation of the liquidity needed to successfully execute the Resolution Strategy.

The Firm is making a number of significant enhancements or changes to comprehensively address the Liquidity section of the 2016 Feedback and 2017 Guidance, including the shortcomings described above, and ensure the adequacy and availability of liquidity to its Material Entities. The Firm is developing a new RLAP model and making associated changes to address all RLAP-related feedback. It is also enhancing its MOL methodology and calculation of peak funding needs to address all RLEN-related feedback. Throughout, the Firm is modeling for inter-affiliate funding frictions and potential ring-fencing considerations to ensure the feasibility of its Resolution Strategy across a range of alternative outcomes. All such enhancements build on and complement the Firm's existing suite of Contingency Funding Plan ("CFP") liquidity stress tests and its Resolution Financial Model which was developed for the 2015 Plan.

#### **4.1.1 Resolution Liquidity Adequacy and Positioning**

##### ***Action One: Develop RLAP Model***

The Firm's new RLAP model will measure the stand-alone net liquidity position of each Material Entity under a 30-day idiosyncratic scenario, capturing both external and inter-affiliate exposures, as well as additional frictions associated with ring-fencing actions. The RLAP model will require that Material Entities maintain liquidity in excess of their respective MOL after application of the 30-day scenario. In developing the RLAP model, the Firm undertook a systematic and extensive review to identify inter-affiliate and ring-fencing exposures with potential liquidity risk. The Firm is also taking steps to mitigate or eliminate much of the liquidity risks identified during this process.

When completed prior to the submission of the 2017 Plan, the Firm's new RLAP model will be part of the Firm's BAU liquidity stress testing framework and will be run with all of the other tests that serve to inform the Firm's required liquidity reserve.

**Action Two: Enhance Cash Management Operations**

The Firm is fundamentally changing the way it manages its cash through the implementation of a legal entity funding process for its Material Entities. Cash was previously managed at the consolidated level for a given currency or agent bank, and intraday flows across legal entities were netted. The new cash management process will use the entity's own cash deposits and liquidity inflows, to the extent possible, rather than relying on MS Parent deposits. Additionally, by increasing deposits held at the entity level, rather than primarily at MS Parent, this new funding process in part addresses the 2016 Feedback's observation that, under severe stress scenarios, MS Parent deposits may not be readily available to fund other entities. The Firm is pursuing alternate placements to agent banks for those deposits that will remain at MS Parent.

**Action Three: Develop and Implement a Financial Resource Positioning Framework**

Substantial capital and liquidity is already positioned in several Material Entities. As of June 30, 2016, MS Parent held liquidity reserves of \$61 billion in cash, cash equivalents and unencumbered highly liquid securities, with an additional \$146 billion of liquidity reserves held by its subsidiaries, as shown in Exhibit 1.

Exhibit 1: Liquidity Reserves as of June 30, 2016<sup>14</sup> (\$Bn)

	Domestic Subsidiaries	Foreign Subsidiaries	Total Subsidiaries	MS Parent	Total
Bank Subsidiaries	\$86	\$6	\$91	-	\$91
Non-Bank Subsidiaries	\$18	\$38	\$55	\$61	\$116
Total	\$103	\$43	\$146	\$61	\$207

Although some level of positioning of financial resources at Material Entities is beneficial in a resolution scenario, certain regulated Material Entities may be vulnerable to ring-fencing. Positioning more resources than each Material Entity would, with some degree of certainty, need in a crisis could therefore pose a risk to execution of the Resolution Strategy by isolating in ring-fenced Material Entities resources that would otherwise be available to be downstreamed from MS Parent to the other Material Entities.

The Firm is developing a financial resource positioning framework to determine the appropriate level of liquidity and capital to hold at each Material Entity and at MS Parent. The positioning framework will incorporate quantitative and qualitative considerations and will balance the

<sup>14</sup> Source: Morgan Stanley 2Q2016 10-Q. Numbers may not sum due to rounding.

benefits of certainty associated with positioning at Material Entities with the flexibility provided by holding resources at MS Parent against alternative failure scenarios. The Firm will also position and maintain sufficient working capital in its Material Service Entities to, among other things, ensure the continued resiliency and solvency of these service entities in support of its operational continuity strategy. The framework will be developed and implemented, with resources positioned, prior to July 2017 and will be described in detail within the 2017 Plan.

#### **4.1.2 Resolution Liquidity Execution Need**

Under the Resolution Strategy, the liquidity required to execute the solvent wind down of the Firm's ISG Material Operating Entities as well as the sale of its Wealth Management and Investment Management businesses over a 12-month Resolution Period constitutes the Firm's RLEN. To support its assessment of RLEN, the Firm developed the Resolution Financial Model, which estimates the amount of capital and liquidity needed by each Material Entity to execute the Resolution Strategy. The Firm will enhance its Resolution Financial Model to incorporate inter-affiliate flows, funding frictions and peak outflows during the Runway Period and Resolution Period, as well as an enhanced, more detailed MOL methodology.

##### ***Action One: Incorporate Inter-Affiliate Flows and Funding Frictions Within the Firm's RLEN Methodology***

As mentioned above, for purposes of developing its RLAP model, the Firm identified key categories of inter-affiliate financial relationships that need to be considered for residual liquidity risk. The same analysis was leveraged for considering the inter-affiliate funding and ring-fencing frictions for purposes of the RLEN methodology.

##### ***Action Two: Enhance MOL Methodology***

The Firm's MOL methodology must provide, by Material Entity, a breakout and supporting analysis for the following components of MOL:

- ***Intra-day liquidity requirements***, which consist of both intra-day cash requirements and intra-day non-cash collateral requirements that the Firm has to run its daily operations;
- ***Inter-affiliate and other funding frictions***, which consist of incremental intra-day cash needs for Material Entities under a ring-fencing scenario, where Material Entities cannot receive intra-day funding from MS Parent;
- ***Operating expenses***, which consist of forecasted compensation and non-compensation expenses for Material Entities; and
- ***Working capital needs***, which represent the end of day liquidity usage under BAU conditions.

While the current methodology incorporates the four MOL components listed above, the Firm will make enhancements to its MOL methodology that will, among other things, reduce inter-affiliate and other funding frictions.

## 4.2 Derivatives and Trading Activities

The 2016 Feedback identified a two-part Derivatives and Trading Activities shortcoming in that the 2015 Plan:

- Did not estimate the costs or risks associated with hedging the Firm's derivatives exposures; and
- Did not provide a sufficient level of detail on the residual derivatives portfolio.

The Firm's Resolution Financial Model is used to estimate the financial resources required to execute an orderly, active wind down of the Firm's ISG Material Operating Entities over a 12-month Resolution Period. The Firm will enhance this model to address the two-part shortcoming received from the Agencies within the 2016 Feedback. The Firm will continue its efforts to automate this model, with model outputs offering increased transparency into the Firm's financial adequacy to execute its Resolution Strategy.

The Firm will take the following Actions to address the 2016 Feedback regarding the use of hedging in its active wind down analysis and the residual derivatives portfolio.

### ***Action One: Evaluate Use of Hedges and Incorporate Applicable Hedging Costs into the Firm's Active Wind Down Analysis***

The Firm's 2015 Plan did not assume the use of hedges for its derivatives portfolio, and thus did not include estimates of costs or risks associated with hedging activity. Notwithstanding this, for the 2017 Plan, the Firm will assess the use of listed and centrally cleared derivatives to hedge its exposures and, if applicable, will incorporate estimates of any costs and benefits associated with such hedging activity within the Resolution Financial Model. Due to uncertainty surrounding the Firm's ability to enter into these transactions following an MS Parent bankruptcy filing, the Resolution Financial Model will also continue to assess the resource requirements to execute the Resolution Strategy, exclusive of any use and related impacts from hedging activity.

### ***Action Two: Incorporate Detailed Characteristics of the Residual Portfolio***

The Firm will include further details on the residual portfolio in the 2017 Plan, including its size, complexity and potential counterparties. Increased granularity related to the characteristics of the residual portfolio was developed and available within the Resolution Financial Model and the Firm will include this detail within its 2017 Plan.

### ***Additional Actions to Address 2017 Guidance***

In addition to the actions identified above to address shortcomings, the Firm will also make the following enhancements to address the 2017 Guidance:

- **Capabilities.** The Firm currently has the required capabilities and governance framework to support controls over its external and inter-affiliate derivatives booking practices and the associated documentation of its derivative booking model practices on

a Material Entity basis; the Firm will continue to enhance its systems to better capture and monitor market and liquidity risk transfers between legal entities as a result of inter-affiliate derivative transactions.

- **Stabilization Period.** The Firm will build a Stabilization Period, which would take place immediately following bankruptcy, into its modeling.
- **Active Wind Down.** The Firm will make enhancements to its Resolution Financial Model to include impact estimates associated with the active wind down of inter-affiliate derivative transactions. The Firm will model the rate of wind down of inter-affiliate valuation segments consistently with their external counterparts and incorporate associated exit costs as per the tables in the Appendix to the 2017 Guidance.
- **Passive Wind Down.** The Firm will develop a model to estimate the financial resources required to support a passive wind down of its derivatives and trading portfolio. Under a passive wind down scenario, the Firm will only utilize the passive mature and hold exit strategies and will not utilize any active exit strategies.

### 4.3 Governance Mechanisms

The 2016 Feedback identified the following Governance Mechanisms shortcomings in the Firm's 2015 Plan: (i) the 2015 Plan did not include triggers that directly connect the provision of support needed to execute the Resolution Strategy with the decision for MS Parent to file for bankruptcy and (ii) the 2015 Plan included limited analysis of the potential legal challenges that could adversely affect the Firm's approach to providing support under the Resolution Strategy.

In order to address these Governance Mechanisms shortcomings, the 2016 Feedback stated that the 2017 Plan should:

- Include specific triggers to inform the timely execution of a bankruptcy filing and related pre-filing actions. The triggers should be based, at a minimum, on capital, liquidity and market metrics and should incorporate the results of the Firm's models for forecasting the liquidity and capital needed to operate following a bankruptcy filing; and
- Further develop a detailed legal analysis of the potential state law and bankruptcy law challenges and mitigants to the planned provision of support under the Resolution Strategy. The 2017 Plan should also include those mitigants to potential challenges to the planned provision of support under the Resolution Strategy that the Firm considers most effective and the Governance Playbooks included in the 2017 Plan should include any developments stemming from the above analysis.

This section describes the specific actions the Firm is taking to address these Governance Mechanisms shortcomings, as well as related requirements in the 2017 Guidance.

### 4.3.1 Playbooks and Triggers

#### ***Action One: Enhance and Expand Trigger Framework in 2015 Plan***

The Firm will enhance and expand upon the Runway Period triggers and related escalation processes included in its 2015 Plan to include its full continuum of triggers from BAU, through to the execution of pre-bankruptcy filing actions and MS Parent's execution of a bankruptcy filing. The Firm's 2017 Plan will include a full continuum of triggers based on liquidity and capital metrics, which will be linked to specific Firm actions and which will identify when and under what conditions the Firm, including MS Parent and its Material Entities, would transition from BAU conditions to a stress period and from a stress period to the Runway Period and Resolution Period.

These triggers will be designed in such a manner that breach of the triggers would occur early enough to ensure that resources can be downstreamed from MS Parent to the Material Entities prior to MS Parent's filing for bankruptcy and with adequate time for the preparation of the bankruptcy petition and first-day motions, necessary stakeholder communications and requisite board actions. These triggers will be described in the Firm's Governance Playbooks that will be included in the 2017 Plan.

In order to address the 2017 Guidance, the Firm will create a Governance Playbook for the MS Parent Board and each Material Entity Board in its 2017 Plan to confirm it has properly analyzed its governance mechanisms from the perspective of the Boards of MS Parent and each Material Entity.

### 4.3.2 Pre-Bankruptcy Parent Support

#### ***Action One: Perform a Detailed Legal Analysis of Potential Creditor Challenges***

Accelerating the requirements of the 2016 Feedback and the 2017 Guidance, the Firm has performed a detailed legal analysis of the potential creditor challenges to the anticipated 2017 Support Agreement framework to confirm its effectiveness in mitigating the risk of potential creditor challenges relating to:

- Intentional fraudulent transfer;
- Constructive fraudulent transfer;
- Preferential transfer;
- Breach of fiduciary duties; and
- Certain equitable remedies in debt instrument covenants.

#### ***Action Two: Adoption of Enhanced Support Agreement***

The Firm is enhancing the 2017 Plan to include the amended 2017 Support Agreement incorporating the Firm's new and amended trigger framework, a broad collateral package and perfected senior security interests in that collateral package.

### ***Action Three: Establish a Broad MS Parent Collateral Package***

The security agreement securing MS Parent's obligations under the 2017 Support Agreement (the "**Security Agreement**") will include a broad MS Parent collateral package that will secure on a senior basis its support obligations to the Material Entities. The broad collateral package in the Security Agreement will include MS Parent's assets that could be used to make capital or liquidity contributions to the Material Entities, including deposits at controlled or third-party banks, debt investments in subsidiaries, including Material Entities, investments in marketable securities and other cash and non-cash equivalent investments.

### ***Action Four: Perfect Security Interests in Broad MS Parent Collateral Package***

Perfecting the Material Entities' security interests in the collateral package via UCC-1 filings and control agreements will put the public and third-party banks and securities depositories, respectively, on notice that MS Parent has granted a secured interest in its assets to the Firm's Material Entities. Third-parties that continue to hold MS Parent debt or purchase newly issued MS Parent debt from the point of perfection forward would be, or should reasonably be, aware of the existence of the secured interest, and their likelihood of claiming and succeeding on potential claims should be further reduced.

### ***Action Five: Develop and Implement a Financial Resource Positioning Framework***

Positioning capital and liquidity in Material Entities in a manner that balances the benefits of certainty associated with pre-positioning at Material Entities with the flexibility provided by holding resources at MS Parent will further mitigate any risk of creditor challenges to MS Parent support as it lessens the amount potentially subject to such challenges since Material Entities can use resources they already possess to satisfy payment obligations as they come due rather than relying on support from MS Parent.

## **4.4 Capital**

The Firm's 2016 Feedback did not include any Capital-related shortcomings. This section describes the actions that the Firm is taking in connection with the 2017 Guidance on Capital.

### **4.4.1 Resolution Capital Adequacy and Positioning**

The Firm maintains a significant amount of total loss absorbing capital, inclusive of long-term debt, which supports its ability to recapitalize its Material Entities to adequate levels that would allow these entities to continue to operate after an MS Parent bankruptcy. Nonetheless, the Firm is also enhancing the processes that support the management and maintenance of loss absorbing capital to address incremental requirements described in the 2017 Guidance.

The Firm will enhance its capital planning and management process to include a financial resource positioning framework, which will determine the appropriate level of capital to hold at each Material Entity and at MS Parent.

To mitigate the risk of potential challenges to the use of pre-positioned internal loss absorbing capital in the form of inter-company debt, the Firm will conduct a review of the characteristics of inter-company debt between all entities in the chain between MS Parent and each Material Entity.

#### **4.4.2 Resolution Capital Execution Need**

The Firm's RCEN methodology is consistent with the 2017 Guidance's requirements on positioning of internal total loss absorbing capital and maintaining sufficient capital as required to maintain market confidence under the Resolution Strategy. The maintenance of sufficient capital is based on a bottom-up analysis and conservative forecasts for losses and resolution expenses, risk-weighted assets and additional capital needs through the Resolution Period.

While the Firm believes the 2015 Plan's approach to estimating capital execution needs was consistent with the 2016 Feedback and 2017 Guidance on RCEN, the Firm is reevaluating its approach to estimating capital execution needs in light of the 2016 Feedback and 2017 Guidance and will amend the associated terminology, as appropriate, in its 2017 Support Agreement and 2017 Plan.

### **4.5 Operational**

The Firm's 2016 Feedback did not include any Operational continuity-related shortcomings. These sections describe the actions that the Firm is taking in connection with the 2017 Guidance on Operational continuity, as well as the continuing execution of significant structural changes to assure continuity of access to critical services.

#### **4.5.1 Payment, Clearing and Settlement Activities**

The Firm is developing enhanced playbooks for each of its top 20 FMU relationships for inclusion in the 2017 Plan,<sup>15</sup> including updated playbooks for the five included in the 2015 Plan, adding a playbook for its relationship with its top agent bank and drafting a single playbook that covers the Firm's relationships with its remaining top agent banks. These playbooks outline the Firm's understanding of additional heightened requirements these payment, clearing and settlement providers might implement in the event of material financial distress, and the Firm's capacity to respond to each for each of the Firm's top payment, clearing and settlement providers. The Firm has also continued to enhance its FMU and agent bank analysis by participating in industry-wide efforts and engaging in formal communications with its FMUs and agent banks.

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<sup>15</sup> The Firm has reviewed its top 20 FMUs from the 2015 Plan to confirm that their designations are current.

#### **4.5.2 Managing, Identifying and Valuing Collateral**

The Firm has assessed its ability to produce necessary collateral management-related information contained in both the Federal Reserve's SR 14-1 and the 2017 Guidance through an assessment process which enables the Firm to objectively analyze and formally assess the sufficiency of existing practices required to support robust recovery and resolution preparedness and to ensure that capabilities are benchmarked against explicit regulatory rules, expectations and guidance.

#### **4.5.3 Management Information Systems**

The Firm has MIS capabilities to produce data readily on a legal entity basis, with controls to ensure data integrity and reliability, as expected in SR 14-1. In instances in which the Firm identifies opportunities for enhancement, the Firm has dedicated resources to complete MIS infrastructure projects by July 2017, including by instituting a robust governance and accountability framework and executing detailed project plans, evaluating project interdependencies and prioritizing among different projects.

#### **4.5.4 Shared and Outsourced Services**

The Firm continues to execute on its services program, which comprehensively establishes a global network of Material Service Entities separate from its operating entities, and includes the migration of all shared services to those entities. On March 1, 2016, the Firm successfully migrated the U.S. technology organization, transferring \$1 billion in fixed assets, 3,202 employees and 5,600 contracts from its U.S. broker-dealers into its primary U.S.-domiciled Material Service Entity. The Firm has combined the requirements of the 2017 Guidance with existing SR 14-1 principles and practices to ensure that the Firm's shared and outsourced services implementation plans under the services program address all applicable requirements.

The Firm also launched an enhanced global operational mapping initiative in September 2015 to identify critical business processes and services by defining service relationships between service providers and service receivers. The Firm completed Phase 1 of the operational mapping exercise in April 2016, and the Firm will complete a second and final phase of the operational mapping exercise prior to July 2017 to refresh and refine service relationship data and assessments of resolution criticality.

The Firm is also remediating contracts relating to the Firm's third-party vendors by identifying clauses that may impede execution of the Resolution Strategy and then either amending the relevant contract or developing contingency arrangements. The Firm is also making sure that all critical contracts are stored in appropriate databases, with an ability to identify those contracts and related terms and provisions.

#### **4.5.5 Bankruptcy and ISDA Protocol Playbooks and Emergency Motion**

The Firm's 2017 Plan will include a Bankruptcy Playbook setting forth MS Parent's strategic actions from the Stress Period through the Resolution Period, including (i) an ISDA Protocol Playbook that analyzes issues associated with the implementation of the stay on cross default rights described in Section 2 of the ISDA Protocol and provides an actionable guide to supplement the related motions and memoranda with a day-to-day description of the steps that would be taken in the periods before entering, and upon commencement of, MS Parent's bankruptcy proceeding; and (ii) an enhanced Guarantee Administrative Priority Motion to obtain Bankruptcy Court approval to elevate guarantees of subsidiary QFCs to administrative expense status, consistent with the requirements of the ISDA Protocol and related memorandum.

#### **4.6 Legal Entity Rationalization and Separability**

The Firm's 2016 Feedback did not include any Legal Entity Rationalization and Separability-related shortcomings. This section describes the actions that the Firm is taking in connection with the 2017 Guidance on Legal Entity Rationalization and Separability.

Consistent with its prior efforts to maintain the Firm's rational and resolvable legal entity structure and in response to the 2017 Guidance, the Firm has enhanced its LER criteria and the related assessment framework used to measure the Firm's adherence to such criteria. The Firm has established three pillars of a rational and resolvable legal entity structure:

- Business alignment;
- Resiliency and resolvability; and
- Tracking and monitoring capabilities.

Prior to submission of the 2017 Plan, the Firm plans to further enhance its LER governance process by:

- Developing and executing a policy which would define roles and responsibilities within the LER process and which would provide standards around the determination of LER criteria and the assessment framework and process;
- Providing a centralized and controlled environment for the collection of evidence for indicators and associated governance related to each LER criteria;
- Evaluating the Firm's adherence to the LER criteria, including through review and challenge as well as approval of results by the Firm's Legal Entity Oversight and Governance Committee; and
- Enhancing governance items related to individual indicators for LER criteria to ensure appropriate governance over each criteria, as applicable.

The Firm will enhance its separability analysis for sale options and will document the results of this enhanced analysis in the Marketing and Sales Playbook for each of the sale candidates identified, which will be included in the 2017 Plan. Lastly, the Firm will evaluate the necessary buyer due diligence documents to be stored within a data room and will establish such data rooms to maintain applicable due diligence documents for its sale options.

## 5 Conclusion

The Firm has used three tenets to evaluate the continued credibility of its Resolution Strategy from the perspective of MS Parent and each Material Entity. Exhibit 2 aligns the six vulnerabilities in the 2017 Guidance to the tenets used by the Firm.

**Exhibit 2: Morgan Stanley Approach to Credible Resolution Strategy Development**



The significant actions already taken and continuing to be advanced by the Firm across the three tenets strongly support the credibility of its Resolution Strategy and demonstrate the progress the Firm is continuing to make to enhance its resolvability.

### ***Strategic and Legal Framework***

The Firm's SPOE resolution strategy provides greater assurance that customers and counterparties of the Firm's Material Entities will be paid without any interruption in the Firm's Critical Operations or Critical Economic Functions and without the costs of multiple, potentially competing, insolvency or resolution proceedings. The credibility of the SPOE strategy is demonstrated by the Firm's:

- Maintenance of a clean top-tier holding company designed to ensure the failure of MS Parent will not cause direct defaults to any customers or counterparties of the Firm's systemically important activities;
- Time-tested communications protocols documented in the Financial Stress Communications Playbook, coupled with a new Rating Agency Playbook for the 2017 Plan, for key stakeholders to act (or refrain from acting) in a manner consistent with its Resolution Strategy;
- Trigger and escalation framework alerting decision makers of the potential need to act in a timely manner in a diversity of stress scenarios, including Governance Playbooks and a Bankruptcy Playbook (with draft emergency motion), which will be included in the 2017 Plan;
- Support Agreement framework designed to ensure MS Parent can provide Material Entities with resources in excess of their execution needs in a manner sufficiently resilient to potential creditor challenges;

- QFC continuity through the adoption of the ISDA Protocol and related QFC remediation efforts and elimination of resolution impacting provisions from the Firm's critical inter-affiliate and external service contracts; and
- Rational legal entity criteria that require facilitation of its Resolution Strategy, with an emphasis on minimizing the complexity and number of entities and the separability of its businesses.

### ***Financial Adequacy***

The Firm's substantial capital and liquidity reserves, as well as the increase in the durability of the Firm's funding, including longer weighted average maturity and a significant increase in deposits, in combination with its financial modeling and stress testing efforts, are designed to demonstrate that Material Entities would have access to the capital and liquidity necessary to execute the Firm's Resolution Strategy without threatening the pre-failure resiliency of MS Parent. The Firm's financial adequacy is demonstrated by the:

- Development of an RLAP model that measures the stand-alone net liquidity position of each Material Entity under a 30-day idiosyncratic scenario, captures external exposures, inter-affiliate exposures and a ring-fencing scenario and demonstrates that Material Entities maintain liquidity in excess of their respective MOL post-scenario application;
- Legal entity funding process, including increased cash deposits at Material Entities and alternative placement of remaining MS Parent deposits, to sufficiently mitigate the risk that MS Parent deposits placed at agent banks may become unavailable in a severely adverse scenario;
- Automated Resolution Financial Model that accounts for inter-affiliate frictions and forecasts Material Entity RCEN and RLEN to provide decision makers and key stakeholders with the information necessary to execute the strategy, demonstrate continued Material Entity solvency and monitor strategy progression to the end of the Resolution Period; and
- Placement of additional capital and liquidity in Material Entities and development and implementation of a financial resource positioning framework.

### ***Operational Continuity and Capabilities***

The Firm has made marked progress in demonstrating each Material Entity would have access to the critical personnel, systems, applications, facilities, vendors and other non-financial resources needed to execute its Resolution Strategy and its ability to produce the data and information and perform the processes necessary to execute its Resolution Strategy. The Firm's operational capability is demonstrated by the:

- Movement of critical shared operational resources and services from Material Operating Entities to an operationally and financially resilient global network of Material Service Entities with the ability to provide such critical resources and services agnostic to any particular scenario or strategy;
- Documentation of contracts for all services deemed critical;

- Contractual continuity provided through elimination of resolution impacting provisions from the Firm's critical inter-affiliate and external service contracts;
- Operational Continuity Plan documenting the Firm's strategy to retain employees, continue inter-affiliate service level agreements, maintain access to facilities, fixed assets and vendors, and maintain continuity of technology infrastructure;
- Capabilities evaluation of the Firm's ability to execute certain functions and produce the data, reporting and analysis needed to implement its Resolution Strategy in a timely manner, at the appropriate level of detail, including contractual, financial, risk and operational information;
- FMU and Agent Bank Access Playbook describing the Firm's strategy and the financial analysis that demonstrates the Firm's ability to meet all potential heightened requirements that may be imposed by the Firm's top FMUs and agent banks when the Firm is in material financial distress; and
- Customer Asset Transfer Playbooks describing the Firm's strategy and ability to transfer Prime Brokerage, client clearing and retail customer assets and accounts at rates commensurate with the expected rate of customer requests when the Firm is in material financial distress.

With these actions, the Firm believes that, at the time of the submission of its 2017 Plan, with the market-wide adoption of the ISDA Protocol and related provisions, it will have the capabilities required to execute its Resolution Strategy.

## 6 Forward-Looking Statements

Certain statements contained herein may constitute "forward-looking statements" within the meaning of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements, which reflect management's beliefs and expectations, are subject to risks and uncertainties that may cause actual results to differ materially. For a discussion of the risks and uncertainties that may affect the Firm's future results, see "Forward-Looking Statements" immediately preceding Part I, Item 1, "Business—Competition" and "Business—Supervision and Regulation" in Part I, Item 1, "Risk Factors" in Part I, Item 1A of the Firm's Annual Report on Form 10-K for the year ended December 31, 2015 and "Liquidity and Capital Resources—Regulatory Requirements" and "Regulatory Developments" of the Firm's Quarterly Report on Form 10-Q for the period ended June 30, 2016.

## Appendix A: Material Entities of Morgan Stanley as of the 2015 Plan<sup>16</sup>

“Material Entity” is defined in the regulations implementing the 165(d) Rule as a subsidiary or foreign office of the Firm that is significant to the Firm’s core businesses and critical activities. The Firm has identified seventeen Material Entities for purposes of the 2015 Plan. The Firm’s Material Entities were determined to ensure that a substantial majority of the Firm’s activities would be captured in the 2015 Plan.

### ***Institutional Securities Entities***

Institutional Securities operates its non-bank businesses primarily on five Material Operating Entities as described below. It also operates banking businesses on one Material Operating Entity, MSBNA.

Under the Resolution Strategy, the Institutional Securities business’s Material Operating Entities would be wound down outside of proceedings, with the exception of MSBNA, which would be sold as part of the Wealth Management business.

#### *Morgan Stanley & Co. LLC*

Morgan Stanley & Co. LLC (“**MSCO**”) operates as the Firm’s primary institutional U.S. broker-dealer. MSCO engages in the provision of financial services to corporations, governments, financial institutions and institutional investors. Its businesses include securities underwriting and distribution; financial advisory services, including advice on mergers and acquisitions, restructurings, real estate and project finance; sales, trading, financing and market-making activities in equity securities and related products, and fixed income securities and related products including foreign exchange and investment activities. To conduct this business, MSCO maintains various regulatory registrations, including with the Securities and Exchange Commission (“**SEC**”) as a broker-dealer and with the Commodity Futures Trading Commission (“**CFTC**”) as a futures commission merchant and provisionally as a swap dealer.

#### *Morgan Stanley & Co. International plc*

Morgan Stanley & Co. International plc (“**MSIP**”) operates as the Firm’s main European broker-dealer and is a UK authorized financial services firm whose principal activity is the provision of financial services to corporations, governments and financial institutions. MSIP’s services include capital raising; financial advisory services, including advice on mergers and acquisitions, restructurings, real estate and project finance; corporate lending; sales, trading, financing and market making activities in equity and fixed income securities and related products, including foreign exchange and commodities; and investment activities. MSIP is authorized by the Prudential Regulation Authority (“**PRA**”) and regulated by the Financial Conduct Authority and the PRA, and is provisionally registered with the CFTC as a swap dealer.

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<sup>16</sup> A different set of Material Entities may be included in the 2017 Plan, including the potential for additional Material Entities.

### *Morgan Stanley MUFG Securities Co., Ltd.*

MSMS is the Firm's Japanese broker-dealer, operated as a securities joint venture with Mitsubishi UFJ Financial Group, Inc. ("**MUFG**"). The Firm has a 51% voting interest in MSMS and a 40% economic interest in the overall joint venture with MUFG, which includes MSMS and Mitsubishi UFJ Morgan Stanley Securities Co., Ltd. MSMS provides sales and trading, capital markets and research services to corporations and institutional clients. MSMS is primarily regulated by the Japanese Financial Services Agency and is provisionally registered with the CFTC as a swap dealer.

### *Morgan Stanley Capital Services LLC*

Morgan Stanley Capital Services LLC ("**MSCS**") is the Firm's primary OTC derivatives dealer and also centrally manages the market risk associated with a substantial amount of the Firm's OTC derivatives businesses, including transactions cleared by central clearinghouses. Significant products traded include: equity swaps; interest rate derivatives; credit derivatives and FX derivatives, in each case as a dealer. MSCS also holds equities, bonds and listed derivatives as hedges to its OTC derivatives positions. MSCS is provisionally registered with the CFTC as a swap dealer.

### *Morgan Stanley Capital Group Inc.*

Morgan Stanley Capital Group Inc. ("**MSCG**") conducts most of the Firm's Commodities business. MSCG engages mainly in sales, trading and market-making activities in various commodities and, to a lesser extent, foreign exchange products. Commodities traded include, but are not limited to, electricity, natural gas, emissions products, base/precious metals as well as indices. MSCG also trades both listed products that may be cleared through a central counterparty or through affiliates, as well as over-the-counter instruments that may be settled directly with the counterparty. MSCG conducts certain power generation and energy trading activities and owns electricity-generating facilities in the United States. MSCG is provisionally registered with the CFTC as a swap dealer.

### **Wealth Management Entities**

Wealth Management operates its non-bank business primarily on one U.S. broker-dealer entity, Morgan Stanley Smith Barney LLC ("**MSSB**"). Wealth Management also operates banking businesses on one Material Operating Entity, MSBNA, and, to a lesser extent, a second U.S. insured depository institution, Morgan Stanley Private Bank National Association.

Under the Resolution Strategy, MSSB would be sold together with its Material Service Entities, Morgan Stanley Smith Barney Financing LLC ("**MSSBF**"), Morgan Stanley Smith Barney FA Notes Holdings LLC ("**MSSBFA**") and MSBNA.

### *Morgan Stanley Smith Barney LLC*

MSSB is a U.S. registered broker-dealer that provides comprehensive financial services to clients through a network of financial advisors in locations across the United States. MSSB financial advisors serve primarily non-institutional investors with an emphasis on ultra-high net worth, high net worth and affluent investors, providing solutions designed to accommodate individual investment objectives, risk tolerance and liquidity needs. MSSB is registered with the SEC as a broker-dealer and as an investment adviser. As of September 5, 2014, MSSB deregistered as a futures commission merchant. However, it remains registered as an introducing broker with the CFTC and introduces futures business to MSCO.

### *Morgan Stanley Bank, N.A*

MSBNA is a U.S. insured depository institution. MSBNA's business includes both Institutional Securities and Wealth Management products and services. MSBNA provides credit products, on a secured and unsecured basis, principally to the Firm's Institutional Securities and Wealth Management clients. Deposit products are offered principally to the Wealth Management clients. MSBNA maintains an investment portfolio of high quality investment securities, and is also the entity from which a significant portion of the Firm's FX risk is managed. MSBNA is provisionally registered with the CFTC as a swap dealer and is regulated by the Office of the Comptroller of the Currency.

### ***Investment Management Entities***

The traditional asset management business operates its business primarily on two material entities, Morgan Stanley Investment Management, Inc. ("**MSIM Inc.**") and Morgan Stanley Investment Management Limited ("**MSIM Ltd.**"). Under the Resolution Strategy, the Investment Management business's Material Operating Entities would be sold.

### *Morgan Stanley Investment Management, Inc.*

MSIM Inc. operates as a U.S. investment advisor, commodity pool operator and commodity trading advisor. It provides discretionary and non-discretionary investment and risk-management solutions to a diverse client base, which includes government entities, investment companies, pension plans, institutions and corporations worldwide. Its investment strategies span the risk/return spectrum across geographies, investment styles and asset classes, including equity, fixed income, liquidity and alternatives. MSIM Inc. offers advisory services as to the appropriate allocation of assets among multiple separate accounts and/or investment companies or other pooled investment vehicles such as, among others, mutual funds, collective trusts and unregistered funds. MSIM Inc. is registered as an investment adviser with the SEC and as a commodity pool operator and commodity-trading advisor with the CFTC.

### *Morgan Stanley Investment Management Limited*

MSIM Ltd. is a UK authorized financial services firm that engages in portfolio management services on a discretionary basis for institutional clients and pooled vehicles. It also provides distribution services (via a network of third-party intermediaries) for sponsored pooled vehicles. Its investment strategies are focused on equity, fixed income, asset allocation and alternative investments. MSIM Ltd. is primarily regulated by the UK Financial Conduct Authority.

### ***Material Service Entities***

Material Service Entities provide support services, functions and/or resources that are significant to Material Operating Entities, in support of Core Business Lines and Critical Operations. MS Parent provides capital and liquidity support to the Material Service Entities.

Under the Resolution Strategy, MSSBF and MSSBFA would be sold as part of the Firm's Wealth Management business and the rest of the Material Service Entities would be wound down outside of proceedings.

### *Morgan Stanley Services Group Inc.*

Morgan Stanley Services Group Inc. ("**MSSG**") provides professional services including technology and data, business development, human resources and accounting to Firm affiliates. MSSG holds leasehold improvements and related assets for offices in New Jersey and data centers located in Virginia and New Jersey.

### *Morgan Stanley Financing Inc.*

Morgan Stanley Financing Inc.'s ("**MSFI's**") main function is the financing of fixed assets in North America. MSFI indirectly owns and leases properties in New York State for the use by the Firm's operating businesses.

### *Morgan Stanley International Incorporated*

Morgan Stanley International Incorporated ("**MSII**") acts as an employment company that is responsible for the payment of all compensation and benefits due to U.S. employees working in the United Kingdom. These employees are employed by MSII and are seconded to a number of the Firm's UK operating entities.

### *Morgan Stanley Smith Barney Financing LLC*

MSSBF's primary activities are to hold real estate leases for MSSB's branch offices and finance fixed assets for Wealth Management. Its activities are primarily conducted in the United States.

### *Morgan Stanley Smith Barney FA Notes Holdings LLC*

MSSBFA engages in the administration of notes related to the recruiting and retention of MSSB financial advisors and certain financial advisor compensation programs. Its activities are primarily conducted in the United States.

### *Morgan Stanley UK Group*

Morgan Stanley UK Group's ("**MSUKG's**") primary service is to provide physical workspace to the Firm employees residing in the United Kingdom who support the Firm's UK entities including MSIP and MSIM Ltd. The provided physical workspace is all located in the United Kingdom and is leased (not owned) by MSUKG. MSUKG provides a full range of property services in support, including physical security to all of the Firm's UK entities. It also holds assets relating to leasehold improvements and a small balance of technology and data equipment.

### *Morgan Stanley UK Limited*

Morgan Stanley UK Limited ("**MSUKL**") acts as an employment company that is responsible for the payment of all remuneration and benefits due to the Firm employees residing in the United Kingdom who support the Firm's UK entities. These employees are provided to a number of the Firm's UK operating entities. As part of its provision of employment services, MSUKL is the contractual counterparty (the sponsoring employer) to the Firm's pension plan in the United Kingdom.

### *Morgan Stanley Japan Group Co., Ltd.*

Morgan Stanley Japan Group Co., Ltd. provides information technology, administration and personnel-related services, including human resources, payroll, welfare, professional education and training, to Firm affiliates in Japan.

## **Appendix B: Core Business Lines of Morgan Stanley as of the 2015 Plan**

All aspects of the Firm's businesses are highly competitive, and the Firm expects them to remain so in the future. The Firm competes in the United States and globally for clients, market share and human talent in all aspects of its Core Business Lines. The Firm competes with commercial banks, brokerage firms, insurance companies, electronic trading and clearing platforms, financial data repositories, mutual fund sponsors, hedge funds, energy companies and other companies offering financial or ancillary services in the United States and globally.

### ***Institutional Securities***

The Firm provides financial advisory and capital-raising services to a diverse group of corporate and other institutional clients globally, primarily through five Material Operating Entities. The Firm, primarily through these entities, also conducts sales and trading activities worldwide, as principal and agent, and provides related financing services on behalf of institutional investors.

Investment banking and corporate lending activities include:

- Capital Raising;
- Financial Advisory Services; and
- Corporate Lending.

Sales and trading activities include:

- Institutional Equity;
- Fixed Income and Commodities;
- Research; and
- Investments.

### ***Wealth Management***

The Firm's Wealth Management business provides comprehensive financial services to individual investors and small-to-medium-sized businesses and institutions through a network of almost 16,000 global representatives in over 600 locations as of December 31, 2015.

Wealth Management provides clients with a comprehensive array of financial solutions, including products and services from the Firm and third-party providers such as other financial institutions, insurance companies and mutual fund families. Wealth Management provides:

- Brokerage and investment advisory services tracking various types of investments;
- Fixed income principal trading, which primarily facilitates clients' trading or investments in such securities;
- Plan administration for education savings programs, financial and wealth planning services, and annuity and other insurance products;

- Access to cash management services through various banks and other third-parties, as well as lending products, such as securities-based lending, mortgage loans and home equity lines of credit through affiliates;
- Access to cash management and commercial credit solutions to qualified small- and medium-sized businesses in the United States; and
- Individual and corporate retirement solutions (including individual retirement accounts and 401(k) plans), and U.S. and global stock plan services to corporate executives and businesses.

### ***Investment Management***

The Firm's Investment Management business offers clients a broad array of equity, fixed income, liquidity and alternative investments, including fund of funds and single manager strategies. Portfolio managers located in the United States, Europe and Asia manage investment products across the asset class, geographic and capitalization spectrum.

Investment Management delivers its strategies as an advisor through a number of investment vehicles, including separately managed accounts, mutual funds (open and closed end), limited partnerships, sociétés d'investissement à capital variable and collective and pooled trusts. It also provides sub-advisory services.

Investment Management distributes its products through affiliated and unaffiliated broker-dealers, retirement plan platforms and directly. Clients include individual investors and institutional investors, including corporations, pension plans, endowments, foundations, sovereign wealth funds, insurance companies and banks. The client base is both onshore and offshore.

Investment Management typically acts as general partner of, and investment adviser to, its alternative investment funds and typically commits to invest a minority of the capital of such funds, with subscribing investors contributing the majority.